

CHAPTER 6

Entrepreneurship and Small Business Management

6-1 Becoming an Entrepreneur

6-2 Small Business Basics

6-3 Starting a Small Business



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Planning a Career in...

CONSULTING



When businesses face unique problems or undertake major changes, they often turn to consultants for advice and help. Consultants are not long-term employees of a company, but are hired to complete a specific task or to focus on an important challenge facing the business. Consultants may be self-employed and work independently, or they may be part of a large consulting business that employs many specialists. Large companies often form teams of specialists to work with a client.

Consultants bring expertise to a business that may not exist among its employees and that would be difficult to develop quickly enough to solve a current problem. Consultants also may be more objective about the business than people who are working there. The primary work of consultants is to conduct research and complete other types of analysis that help businesses address important challenges they are facing. Consultants often prepare written reports and plans, provide advice to decision-makers, and may even offer help in reorganizing the company and redirecting its efforts.

Employment Outlook

- The employment outlook for business consultants varies by industry, but is generally growing at a better than average rate.
- Employment demand is based on the expertise and reputation of the individual consultant and the consulting business.
- Most consultants have expertise in organizational change, finance, technology, and management.

Related Job Titles

- Business Analyst
- Management Consultant
- Performance Consultant
- Quality Control Consultant
- Security Consultant
- Training Consultant

Needed Skills

- Ability to problem-solve with innovative solutions
- Research and analytical skills
- Specialization in specific aspects of business operations and management
- Effective written and oral communication skills

What's it like to work in ...

Consulting

Erin Gerrard works as a small business consultant for Security Savings Bank. The bank is committed to strengthening its services to small businesses. Security employs a 10-person team to support its small business customers.



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Erin has a degree in accounting, worked five years for a major accounting business, and then operated her own accounting service for five years. The bank asked her to work for them as a small business consultant because of her accounting expertise and reputation in the community. She decided the consulting opportunity would be an interesting challenge.

This morning, Erin is meeting with Dawn Perrot, who is planning to open a florist shop. Dawn has submitted a business plan, but the financial plan is incomplete. Erin is looking forward to helping Dawn gather information and develop a complete picture of the financial needs of her business. Later today, Erin and the bank's information management specialist are visiting The Sherron Company to help them plan a new computerized payroll system.

What about you? How do you believe Erin's work as a consultant is similar to and different from the work she did as the owner of a small accounting business?

6-1

Becoming an Entrepreneur



Goals

Identify characteristics of successful entrepreneurs.

Recognize the importance of entrepreneurship in the economy.

Describe opportunities and risks of entrepreneurship.

Key Terms

entrepreneur

entrepreneurship

venture capital

innovation

improvement

Focus on Real Life

Jerelyn Frank has been working as an aerobics instructor for the Phase 4 Fitness Center for the past six years. Jerelyn enjoys her work because she has always been active and athletic. Since high school, she has taken wellness, first aid, and nutrition classes at the local adult education center. She has completed a number of certification courses in aerobics instruction and yoga. In her spare time, she has developed fitness programs for some of her friends and members of the fitness center where she works.

Jerelyn is seriously thinking about starting a personal fitness service. She wants to go to people's homes and offices to help them plan and maintain a fitness schedule and offer half-hour to one-hour workouts. She already has a number of contacts to help her get underway. Jerelyn is single with no family responsibilities, and she has no debts. She has been able to save more than \$15,000 in her bank account.

Jerelyn decides to go forward with the plan just as thousands of other entrepreneurs do each year. Those that become new business owners are willing to contribute a great deal of time and energy and risk personal economic resources for their venture. They hold the hope of a successful business and a reasonable profit.

main idea

Identify characteristics of successful entrepreneurs.

CHARACTERISTICS OF ENTREPRENEURS

An **entrepreneur** is someone who takes a risk in starting a business to earn a profit. Some key factors in starting your own business are having a real desire to be your own boss and developing a good initial plan. Having special skills and abilities and coming up with innovative ideas are also important.

Can you think of some service or product that is not being offered at this time but that could be in demand? Is there some service or product that you could offer more efficiently than others are doing now? Is there some special talent you have that could become

the starting point for a business of your own? If so, you have the basis for a new business enterprise. There are good opportunities for entrepreneurship through small business ownership. **Entrepreneurship** is the process of starting, organizing, managing, and assuming the responsibility for a business. Here are some real-life examples of young entrepreneurs.

Entrepreneurs in Action

Joshua Moore was a high school student and brother to four-year-old Sophie when he developed an idea for a baby stroller braking system. To fund work on his invention, Josh started Personal

Affections, selling key chains, picture frames, mirrors, and personalized stickers at his Walhalla, South Carolina, high school. He received an Entrepreneur of the Year award for an operational business from the National Foundation for Teaching Entrepreneurship. At age 15, he was on his way to his dream of becoming an inventor and business owner.

Pankaj Arora was not a typical high school student in Rochester, Minnesota. In addition to a busy schedule of schoolwork and after-school activities, he also ran two business ventures. Using his advanced computer skills, Pankaj created and distributed software through his company, Pankaj Arora Software. His second company, paWare, specialized in custom-built computer systems and web design. Along with his college degree, Pankaj's technical and entrepreneurial skills helped him get a job at General Electric.

Rich Stachowski of Moraga, California, is an avid scuba diver. While enjoying his hobby, he recognized that he was unable to talk to others who were snorkeling with him. He put his imagination to work and invented Water Talkies™. These walkie-talkies can be used under water. Rich worked with a family friend who developed the manufacturing process. He then opened a business to make and sell his product before he was even a teenager. His Short Stack line of water toys is now sold by 100 chain retailers in the United States and several other countries.

Sometimes ideas for new products come from problems in daily life. Abbey Fleck was watching her father use a microwave oven to cook bacon one morning in their White Bear Lake, Minnesota, home. The bacon came out soaked in grease. Abbey had an idea to develop a pan that would cook the bacon while letting the grease drain out below. She and her father tested several designs that resulted in the Makin Bacon® microwave bacon tray.



Do you have ideas or skills that you could use to start a small business?

They were able to convince the producers of Armour brand bacon to sell the tray with an advertisement and order form printed on each package of bacon. The product was an instant hit. Abbey's company, A de F, Inc., has sold more than \$3 million worth of Makin Bacon® trays.

NETBookmark

The U.S. government is taking steps to support the more than 6 million women who own their own businesses. One of the resources is a web site dedicated to providing information and networking opportunities to women entrepreneurs. Access the web site shown below and click on the link for Chapter 6. Read the latest news on women's entrepreneurship. Review the types of resources that can be accessed through the web site. Locate other government web sites that provide information and help for people wanting to starting their own businesses.

school.cengage.com/business/introtobiz

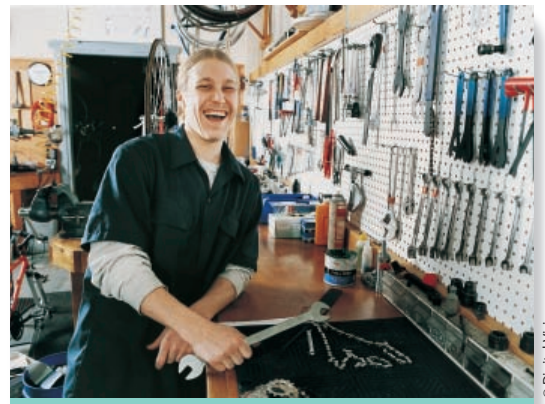
The experiences of these entrepreneurs are examples of the thousands of young people who have creative ideas and turn them into businesses each year. Not all ideas lead to successful businesses, but each provides evidence of the opportunities that exist for people who believe they can turn their idea into a profitable business.

What Does It Take?

Not all people who own or manage a business are entrepreneurs. It takes unique skills and personal characteristics to develop a new idea for a product or service. A person must also have both the confidence and capability to turn an idea into a business.

Entrepreneurs come from all age categories and racial and ethnic groups. They represent both genders as well as varied amounts and types of education. Many entrepreneurs own their first business while in their teens. Others do not take the step until retirement. More business owners are male, but young entrepreneurs are more equally divided between male and female.

It is important to have an understanding of business operations and



What are some advantages and disadvantages of turning a hobby into a business?

management. This understanding does not always come from getting a business degree in college. People learn how to run a business in many ways. They may work in a business or ask for help and advice from an experienced business owner. They may read and study on their own as well as in school.

There are personal traits that are common to successful entrepreneurs, as shown in Figure 6-1. While some people already have many of these qualities, others do not. If you have a desire to become an entrepreneur, you can work to develop these characteristics.

FIGURE 6-1

Which characteristics of successful entrepreneurs do you possess? Which ones would you like to develop?



Personal Characteristics of Successful Entrepreneurs	
ENTREPRENEURS ARE MORE	THEY HAVE
• persistent	• problem-solving skills
• inquisitive	• tolerance for ambiguity
• energetic	• strong integrity
• goal oriented	• personal initiative
• independent	• ability to secure resources
• self-confident	• capability to learn from failure
• creative	• willingness to work hard
• reliable	
• competitive	

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What personal characteristic are common to most successful entrepreneurs?

ENTREPRENEURSHIP AND THE ECONOMY

Entrepreneurship is a key part of the U.S. economy. Nearly one in ten of all Americans 18–64 years old is involved in some type of entrepreneurship activity. More than 670,000 new businesses are created annually. Entrepreneurship is also risky. Nearly as many small businesses close as begin each year.

Employment

Small businesses are responsible for most new employment. Figure 6-2 shows employment growth by firm size between 1993 and 2003. Over 60 percent of new jobs were created by businesses with fewer than 500 employees.

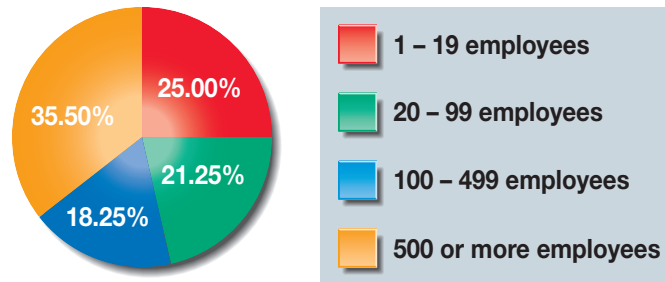
Financing

Most of the money needed to start a new business comes from the entrepreneur and his or her family and friends. One in five Americans has invested in a business of someone they know well. More than 50 percent lend financial support for the business of a family member or relative. Twenty nine percent give money to neighbors and friends. Eight percent invest in businesses started by work colleagues. Family and friends invest more than \$100 billion in new businesses each year.

Another source of money for some new businesses is venture capital.

Venture capital is money provided by large investors to finance new products and new businesses that have a good chance to be very profitable. In the late 1990s, many venture capital companies were formed. They supplied more than

Employment Growth by Business Size (1993–2003)



Source: U.S. Bureau of Labor Statistics

FIGURE 6-2

What percentage of job growth came from businesses with fewer than 100 employees?

\$100 billion each year to new businesses. Many of the businesses receiving those funds were e-commerce and high-tech start-ups. When many of those businesses failed, the amount of venture capital declined to less than \$22 billion in 2005. More than 2,900 companies receive venture capital each year. That shows that many people think new businesses provide a good investment opportunity. The other sources of financing for new businesses are loans from banks and financial institutions and credit given by businesses that sell products and services to the new business.

Productivity

New and small businesses produce a large volume of goods and services for the economy. Businesses with just a single owner and no staff account for more than \$600 billion in sales annually. Small businesses are responsible for more than half of the U.S. gross domestic product each year. They account for 55 percent of all innovative products and services developed.

main idea

Recognize the importance of entrepreneurship in the economy.

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What are the sources of financing that entrepreneurs use for their new businesses?

main idea

Describe opportunities and risks of entrepreneurship.

OPPORTUNITIES AND RISKS

When Jerelyn Frank was deciding whether she would open her own personal fitness business, she had to think about both the opportunities and the risks. Giving up a regular job and stable income is a difficult choice. As benefits, she will have personal control over her own business. She can take personal satisfaction if her idea develops into a successful, profitable company.

New Business Opportunities

The American private enterprise economy promotes innovation and new business development. Individuals are able to take the risk to start a new business. They can compete with other businesses to sell their products and services and make a profit. Consumers are always looking for new and better choices to meet their wants and needs.

Many opportunities are open to prospective entrepreneurs. The opportunities begin with the creation of new or improved products and services. An **innovation** is an invention or creation that is brand new. An **improvement** is a designed change that increases the usefulness of a product, service, or process.

Inventors often develop innovations. Those inventions may become the basis for a new business. The inventor may sell them to another company for development and sale. Examples of well-known innovations include the Apple personal computer developed by Steven Jobs and Stephen Wozniak and Post-it Notes created by Arthur Fry and Spencer Silver. Recent innovations that



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What do innovation, invention, and improvement have to do with entrepreneurship opportunities?

may become successful products include a miniaturized artificial heart, a virtual computer keyboard, and an optical camouflage system that allows people wearing a special reflective material to seem to disappear.

In addition to inventions, innovators create new services that become the basis for a business. Frederick Smith envisioned an economical worldwide system for quickly and efficiently shipping packages. The creation of FedEx was the result. After graduating from college, Paul Orfalea developed neighborhood walk-in photocopying centers known as Kinko's. When the Internal Revenue Service no longer prepared individual tax returns for free, two brothers, Henry and Richard Bloch, created the H & R Block Company. They trained people to provide efficient, low-cost tax preparation services to individual taxpayers.

Not all entrepreneurship opportunities emerge from those types of inventions and innovations. Many come from an improved design, more effective procedures, or greater attention to quality. Entrepreneurs are creative problem-solvers. Those traits lead to ideas for improved products and services.

Work as a Team

New businesses usually need investments from other people. As a team, develop a list of questions you would ask an entrepreneur to determine if the new business would be one in which you would want to invest some of your money.



Recognizing Risks

Many successful entrepreneurs and their businesses are well known. Their success encourages others to think about starting a new business. Developing a successful new business is not easy. Many more new businesses fail than succeed. The time and energy required of new business owners is much higher than most people expect.

The National Federation of Independent Business reports that of all new businesses, about one-third are profitable, one-third do not make a profit but continue to operate, and the remaining third lose money. Over a 10-year period, more than 50 percent of all new businesses are discontinued. The primary reasons that businesses started by entrepreneurs close are

- Lack of adequate capital
- Low sales

- Higher than expected expenses
- Competitive pressure
- An owner unprepared to manage a growing business
- Operations requiring more time than the owner is willing to commit

Entrepreneurs need to be aware of the many risks they may face and prepare for them. Most entrepreneurs are willing to take risks. They will work hard to make their businesses succeed. However, many entrepreneurs have seen one or more of their business ideas fail before they are able to grow a successful company.

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Where do entrepreneurship opportunities begin?

6-1

Assessment



Key Concepts

Determine the best answer.

1. True or False. Everyone who owns or manages a business is an entrepreneur.
2. Which of the following is *not* a characteristic of entrepreneurship in the United States?
 - a. About 3 percent of people aged 18–64 are involved in entrepreneurship activity.
 - b. About 670,000 new businesses are created each year.
 - c. Forty percent of new businesses have no employees.
 - d. One in every five Americans has invested in a business of someone who they know well.
3. Money provided by large investors to finance new products and new businesses that have a good chance to be very profitable is known as
 - a. a loan
 - b. credit
 - c. venture capital
 - d. start-up funding
4. True or False. The primary reason that businesses started by entrepreneurs close is disagreements with business partners.

Make Academic Connections

5. **Math** Ronaldo Jacarda is opening a manufacturing business. It will produce a new type of USB flash storage card for cell phones and digital cameras. He has several sources for the money needed to start his business. Those sources and amounts are personal savings, \$56,500; loans from family and friends, \$38,000; venture capital investment, \$128,000; bank loan, \$22,500. Determine the total amount of capital he has accumulated and the percentage of that total from each of the sources. Prepare a pie chart that illustrates the answers.
6. **History** Use the Internet to identify important inventions and innovations developed in the past 50 years. Select the five you believe have had the greatest business success. Now select the five you believe have been most important in improving society. Prepare a short report in which you identify and briefly describe each of the inventions and innovations you selected and justifications for your choices.



Goals

Identify important characteristics of small businesses.

Recognize the competitive advantages of small businesses.

Identify problems faced by many small businesses.

Key Terms

small business

Small Business Administration (SBA)

Focus on Real Life

During dinner, Jasmine excitedly told her family what happened in her Intro to Business class. The class had spent the time thinking about opportunities for owning a small business. Jasmine knew that is what she wanted to do.

Jasmine's grandfather said, "Did you know I ran a small business for almost 10 years when I was young? I was as excited as you are about starting a business when I graduated from high school. I went to work for the owner of a small hardware store. I hoped that I could save enough money to open my own store. Luckily, after eight years, he decided to retire. We worked out an arrangement where I could buy the store from him over a number of years."

"What happened to the business?" Jasmine asked.

"Being a small business owner is exciting, but it is a difficult life," explained her grandfather. "As the bigger stores moved in, I found it more and more difficult to attract customers. I decided to sell the business. I'm excited for you, but I want you to know that achieving your goals will be challenging."

main idea

Identify important characteristics of small businesses.

SMALL BUSINESS OWNERSHIP

Business is often viewed as very large corporations. These companies employ thousands of people with locations all over the country and the world. That is not the true picture of most businesses. By far the greatest percentage of businesses in the United States is small businesses. Small businesses employ half of all private sector employees.

You may be surprised by the definition of small business used by the federal government. According to the Small Business Administration (SBA), a **small business** is an independent business with fewer than 500 employees. Using that standard, 99.9 percent of the roughly 26 million U.S. businesses are small businesses.

A more specific description of a small business includes the following points.

- The owner is usually the manager.
- It operates in one or very few locations.
- It typically serves a small market.
- It is not dominant in its field.

Most people would probably not consider businesses with 500 employees to be small. Even if you use a standard of fewer than 100 employees, 25 million businesses fit that description. Nearly 18.6 million businesses have no staff other than the owner. Many of those businesses are run on a part-time basis from the owner's home. Twenty million businesses are set up as proprietorships. No matter how you identify small businesses, they are by

far the greatest number of businesses operating today.

Small Business Employment

On average, small businesses are responsible for creating 60–80 percent of all new jobs. Figure 6-3 shows some of the common types of small business. It is not surprising that there are a large number of service businesses. Many small business services are professional and technical. Many construction companies operate as small businesses.

Ownership Diversity

Women own more than one-fourth of all small businesses. More than 18 percent of small businesses have African-American, Asian-American, or Hispanic-American ownership. The

FYI

Small business owners report that the Internet is having a positive impact on their companies. In a recent survey, 51 percent said the Internet helped increase their profits and 49 percent said its use resulted in reduced operating costs.

majority of small business owners are over 35 years old, but nearly 25 percent are under 35. Today, almost all people starting small businesses have at least a high school diploma. Nearly 60 percent have finished some college work.

Half of all small businesses are home-based businesses. Because many businesses are part-time ventures or service businesses, the owners report that

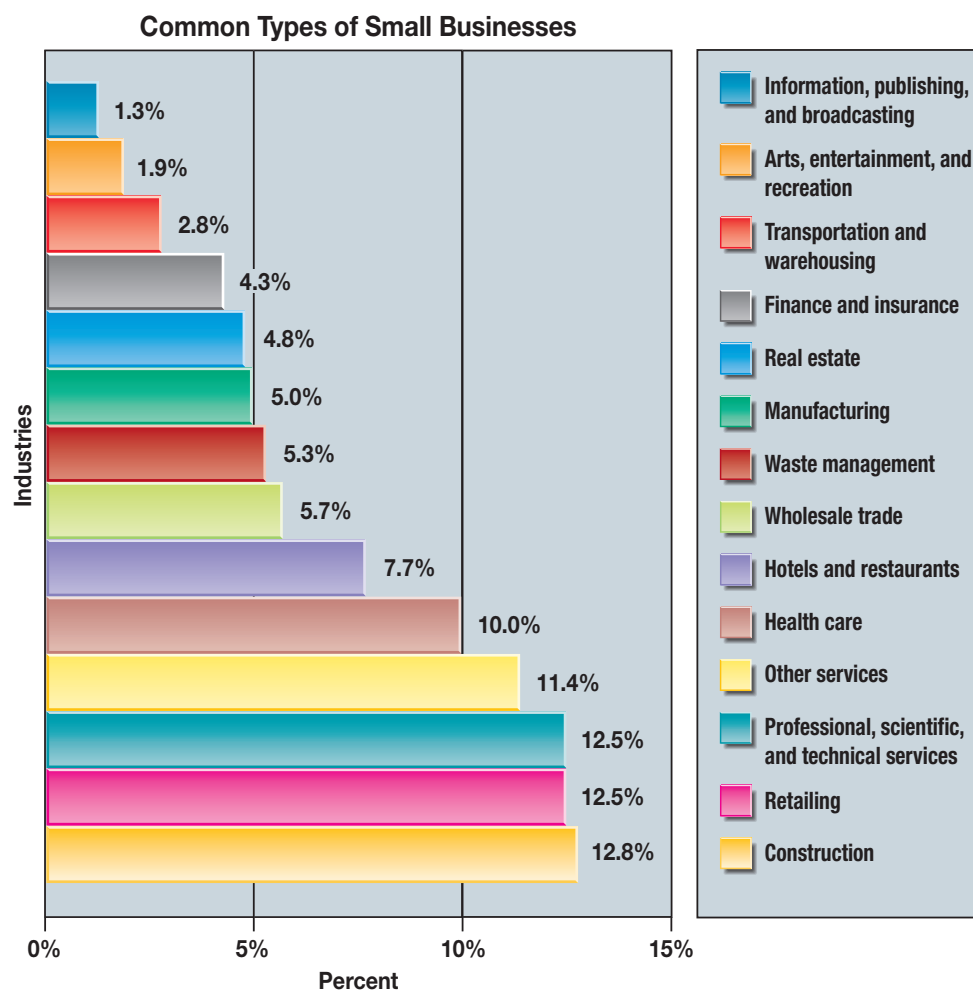


FIGURE 6-3

Why are so many small businesses in services and retailing?

on average they needed \$5,000 or less to start that type of business. Full-time businesses with buildings, equipment, and employees may require more than \$100,000 of initial capital.

checkpoint >>

What percentage of employees in the United States work for small businesses?

main idea

Recognize the competitive advantages of small businesses.

SMALL BUSINESS ADVANTAGES

You need someone to mow your lawn, make a gourmet meal in your home for a few close friends, build a custom display case for a model train, or repair hardware on your home computer. Where would you turn for help? It's not likely that you will find a large business for any of those services.

Meeting Customer Needs

Small businesses play a vital role in the economy. They often serve customers where the number of products and services needed is small or the requirements are too specialized for large businesses to make a profit. It is easier for a small business to meet the precise needs of customers than a large business. Even though a large business has more resources, to operate efficiently it must focus on products and services that meet the needs of a large group of customers. That makes it harder to satisfy the unique needs of single customers.

Small businesses often are not able to match the lower operating costs

of larger businesses. They can compete by paying attention to their customers. Small businesses serve fewer customers and usually have more frequent contact with those customers than large businesses. They are more likely to be located close to the customer. They depend less on other businesses to distribute or service their products.

Large businesses often rely on consumer research to gather information. Small businesses usually get direct information from their customers about what they like and dislike.

Providing Unique Services

Small businesses are especially suited to provide unique services for customers. They may plan a wedding or design a customized sound system for your home. Providing those types of services means that business representatives must take a special interest in the customer. They spend time determining needs and



How do small businesses provide unique services that large businesses cannot?

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discussing alternatives. They have the expertise to plan and deliver the services that satisfy the customer. Large businesses may not find it profitable to spend that much time with each customer. Each employee that works with customers may not have the expertise to design the needed service.

Big business has a clear advantage when a large number of customers are willing to buy standard products and prefer low cost and efficient delivery. Small businesses gain an advantage when customers have unique needs, want more individual attention, and are willing to pay a bit more for the product or service to obtain what they really want. When asked, “What businesses do you believe are most concerned about you as a customer?” the majority of consumers identify small businesses.

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How can small businesses compete successfully with larger businesses?

COMMON SMALL BUSINESS PROBLEMS

Not all small businesses succeed. In fact, their failure rate is much higher than larger businesses. Many failures result from the inability to pay expenses. The business is then forced to close. Some companies quietly go out of business when the owner believes that he or she is not doing well enough to continue. The owner may also get tired of the long hours and hard work.

Reasons for Failure

The following are the most common reasons for small business failure:

- Not keeping adequate records
- Not having enough start-up money

Work as a Team

Identify two or three small businesses in your community that have been successful for many years. As a team, discuss what you think these businesses do that allows them to compete successfully with other small and large businesses.



- Lack of management experience
- Lack of experience with the type of business
- Not controlling operating expenses
- Poor location for the business
- Failure to manage credit offered to customers

main idea

Identify problems faced by many small businesses.



What do you think would be the hardest part of managing a small business?

Small Business Assistance

With the right kind of assistance, small businesses can overcome each of the causes of failure listed above. Small business owners can get help from a number of sources. Universities and colleges often have faculty members who can give advice and support to people who are starting or have started their own businesses.



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Where can small businesses find assistance?

Local groups of businesspeople, such as Chambers of Commerce, have members who can help others with business problems.

The **Small Business Administration (SBA)** is a government agency that helps small business owners develop business plans and obtain financing and other support for their companies. Information about the SBA and its services can be obtained by visiting www.sba.gov.

The SBA offers information, publications, counseling, and many other forms of support. The SBA sponsors the Service Corps of Retired Executives (SCORE). Members of SCORE are retired local businesspeople who volunteer their services to counsel and mentor new business owners.

checkpoint >>

List common reasons for small business failure.

6-2

Assessment



Key Concepts

Determine the best answer.

1. The Small Business Administration considers a business small if it employs fewer than __?__ employees.
 - a. 5
 - b. 20
 - c. 100
 - d. 500
2. A competitive advantage that small businesses have over larger businesses is
 - a. lower costs
 - b. more consumer research
 - c. lower prices
 - d. attention to unique customer needs
3. Which of the following is *not* one of the reasons small business fail?
 - a. poor customer credit practices
 - b. the owner does not have adequate experience
 - c. a poor business location
 - d. not enough employees to do the work

Make Academic Connections

4. **Technology** eBay has become the home of many small businesses. Thousands of small business owners earn an excellent income by selling their products using the online auction services provided by eBay. Visit the eBay web site and identify three ways a small business can use the web site to support its operations.
5. **Communication** Interview a small business owner who has operated his or her business for at least three years. Determine the factors that have contributed to success as well as the major challenges that have been faced. Prepare an audio or video presentation based on your interview.
6. **Research** Interview 10 people who have recently purchased products or services from a small business. Ask them to list the top three reasons they made the purchase from a small business rather than a large business. Summarize the results from your interviews and present your findings in a table or chart.



Sharpen Your Life Skills

Writing with Technology

Today's technology allows written communication to be exchanged at a much faster pace. Traditional forms of written communication, including letters, reports, and brochures, have not changed. However, when composed and completed, they can be sent to recipients in minutes using the Internet.

Many uses of traditional written communication have been replaced by instantaneous informal communications including text messaging, instant messaging, and e-mail. The immediate nature of the technology as well as the informal approach to composing those messages often result in poor communication or even miscommunication. When you use technology for written communication, especially in business, a few basic rules will demonstrate to your recipients that they are important and you want to communicate effectively.

The two primary types of communication used in business are memos and e-mail messages. Memos are formal and are used to convey more complex information. Send a memo when there is a need for a more permanent record of your correspondence or there is a need for formal language, or if the information included would make an e-mail too long. E-mail is more informal and used for direct and brief communication. Here are some important guidelines.

When Composing a Memo

1. **Know your audience.** Direct your memo to one person or a small group of people. Who needs the information? What do they need to know?
2. **Focus on one specific subject.** Make sure the subject is important to the audience. Specifically identify the subject of the memo. Do not stray into other topics.
3. **Select your words carefully.** Use language appropriate for the organization and understandable to your audience. Be clear, direct, and objective.
4. **Start strong.** Have an attention-getting first sentence. Focus the attention of the reader and get to the point.

5. **Provide only needed information.** Keep the memo brief, usually no more than one page, so it can be read in a few minutes. Before you end, be sure the information is complete.
6. **End effectively.** Identify any action needed and emphasize the importance of the information.

When Composing an E-mail Message

1. **Send only to the people who need the information.** Do not "reply to all" or use a mass e-mail list. Use e-mail for more individualized and specific messages.
2. **Use a specific subject line.** People get many e-mails. They can read and respond more efficiently if they can identify a clear subject.
3. **Provide a context.** If you are responding to an e-mail, briefly identify the information to which you are responding. Provide any information needed by the reader to understand your message.
4. **Don't get caught up in the technology.** Avoid "flaming" with all caps or inserting emoticons, flashing text, or other gimmicks that detract from the information.
5. **Keep the message short.** An e-mail should be read in about a minute. If the message is longer, send it in a different format or add an attachment or link.
6. **Don't write in haste.** You may regret an emotional message sent in haste. Consider the effect your message may have on the recipient.
7. **Even when informal, use effective writing skills.** Write in complete, active sentences, organize using paragraphs, and check your spelling.
8. **Use e-mail to create a record.** E-mail servers hold records of your files, even after you think they are deleted. If you need a record of a memo, use e-mail.

Think Critically

1. When should you send a memo rather than an e-mail?
2. What are the communication problems that are most likely to occur when using instant communication methods?

Starting a Small Business



Goals

Recognize important factors to be considered when starting a business.

Describe the elements of a business plan.

Identify types and sources of financing for a small business.

Key Terms

business plan

start-up financing

short-term financing

long-term financing

Focus on Real Life

Jermaine Anderson turned his baseball card hobby into a business. He had a small store in a mall where he bought and sold collectors' baseball cards and other baseball memorabilia. Jermaine began his business with a small loan from the bank and money saved from working while in college.

The business grew steadily each year. Jermaine prepared a specific budget at the beginning of each year. He was able to spend his money wisely on new inventory, advertising, and improvements to his store.

This year he used the same budgeting process that he had for the past four years. Based on last year's results, he estimated that sales would increase 8 percent. He planned to increase expenses accordingly. Even with the increased expenses, the budget projected another nice profit.

The first two months of the year went well. Then the economy slipped into a recession. Customers cut back on their spending at his store. Jermaine's sales were declining while his expenses continued to increase. Jermaine studied his budget to determine why he had problems in the fifth year when his planning had been so successful in the past.

main idea

Recognize important factors to be considered when starting a business.

THE BUSINESS DECISION

Many people think about starting a business. Few actually do. The procedures followed to start a business often determine whether it will be successful. The process begins with an idea and concludes with a careful study of information to establish whether the idea can be successful.

An Idea Plus Experience

Every business begins with an idea. Business ideas come from many sources. Hobbies, interests, and business experiences often give people ideas for new businesses. Books and magazines suggest new business opportunities, including available franchises. Few people should think about starting a business without

working for some time in a small business. Several years of training in a range of business operations will prepare you for the role of owner. Having responsibility for decisions and opportunities to manage people is a key part of that experience.

Right Place and Time

Putting your business idea into action means finding the right place to open the business. Most retail businesses need good customer traffic. If the business is not easy to find or requires a great deal of travel time, many potential customers will stay away. A wholesaler needs easy access to manufacturers where products are obtained for resale



to other businesses. Manufacturers must be located in an area with access to the raw materials used in manufacturing. Transportation systems must also be easy to reach for distributing finished products. Timing is another key factor in starting a business. Most successful businesses start during a period when customer demand for certain products or services is high.

Team Approach

Many small business owners are quite independent. They started their businesses because they do not want to take direction from other people. A business is not easy to run without the help of others. Even the smallest businesses need a few full- or part-time employees to grow or cover extended hours. The employees must be chosen carefully for their ability to work as a team. Choosing the “team” members becomes one of the most important initial business decisions.

In addition to employees, small business owners will need assistance from people with specialized business knowledge. These include bankers, lawyers, and accountants. If possible, the new owner should identify business professionals who focus on working with small businesses.

Preparation and Research

The most important step in starting a business is preparation. Preparation includes having enough information to make good decisions about the business. Time spent gathering and studying information before the

Work as a Team

You are planning to open a small business that will rent bicycles, rollerblades, push scooters, and electric scooters by the hour for people to use for relaxation and exercise. As a team, identify three possible business locations in your community and discuss which location would be best for the business. Prepare a presentation that compares and contrasts the locations. Use visuals such as maps, photos, and drawings to help illustrate your presentation.



business is started will save time and avoid later problems.

Information is needed about customers, competitors, important operations, government regulations, and many other topics. This information is available through libraries, colleges or universities, and small business assistance centers. At times, the new business owner will have to do further



Is there a small business assistance center in your neighborhood? What resources can you use to locate the closest center?

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research to gather more current data. Information will help to make sure that decisions are made objectively.

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Why is it important to use a team approach when starting a new business?

main idea

Describe the elements of a business plan.

DEVELOPING A BUSINESS PLAN

When successful businesses are compared with those that failed, one factor stands out as the most important difference. The owners of successful businesses develop and follow a business plan. The owners of businesses that fail often do not have a business plan.

Elements of a Business Plan
Description of the Business <ul style="list-style-type: none"> the business idea major products and services ownership structure strengths/weaknesses long- and short-term goals
Customer Analysis <ul style="list-style-type: none"> description of customers location, number, and resources of customers sales forecasts
Operations Plan <ul style="list-style-type: none"> organization of the company description of major operations analysis of resources needed human resource plans
Marketing Plan <ul style="list-style-type: none"> description of major marketing activities description of resources needed schedule of marketing activities
Financial Plans <ul style="list-style-type: none"> start-up costs short- and long-term financial needs sources of financing budgets and financial statements

FIGURE 6-4

Why are each of these elements important when planning a new business?

What Is a Business Plan?

A **business plan** is a written description of the business idea and how it will be carried out, including all major business activities. Key features of a business plan are a general description of the company, the credentials of the owner(s), a description of the product or service, an analysis of the market (demand, customers, and competition), and a financial plan. Most business plans are developed for one year and then updated for the next year. If the business owner needs help from others, especially for financing the new business, a business plan will usually be required. Figure 6-4 is an outline of the sections of a business plan.

Even if help is not needed, a business plan should be developed. By developing a plan, the owner is forced to think about important activities, the amount of time they will take, and their cost. This process may identify potential problems. The plan also serves as a guide to keep the business on track.

Steps in Developing the Business Plan

The business owner is in charge of developing the business plan. The most popular use of business plans is to persuade lenders and investors to finance the venture. A well-developed plan will lay out an idea and will require an owner to analyze his or her concept and make decisions about key business activities such as production, marketing, staffing, and financing.



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Where can the entrepreneur find help in creating a business plan?

Some owners hire someone to write the plan. Others get help from a bank or a local office of the Small Business Administration. Even if others are involved in developing the plan, the owner must be familiar with all of the information and make the major decisions for the plan.

The first step in developing the business plan is to gather and review information. If possible, the owner should review other business plans and study information on the activities and financial performance of similar businesses, especially potential competitors.

Next, the owner should develop strategic alternatives. Alternative plans for production, marketing, staffing, and financing should be studied and identified. The owner

can select the best choices from the alternatives.

Finally, each section of the business plan should be written. A plan devotes several sections to a general description of the business. These sections include the basic legal form of the organization and major products or services. Other sections detail the competition, potential customers, operations, marketing, and finances. Before the plan is completed, the owner should have business experts review the plan and offer their advice about its strengths and weaknesses.

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What are "strategic alternatives" in a business plan?

main idea

Identify types and sources of financing for a small business.

FINANCING THE SMALL BUSINESS

A new business with a good product or service may run out of money before it can become profitable. Several years of operation are required before most new businesses earn a profit. Finding adequate financing is a key step in starting and running a new business.

Types of Financing

Three types of financing must be considered. **Start-up financing** is the amount of money needed to open the business. It includes the cost of buildings, equipment, *inventory* (products or raw materials on hand), supplies, licenses, and the like. **Short-term financing** is

the money needed to pay for the current operating activities of a business. Short-term financing is obtained for a period of less than a year and often for one or two months. **Long-term financing** is money needed for the main resources of a business (such as land, buildings, and equipment) that will last for many years. These resources usually require large amounts of money and will be paid over many years.

Sources of Financing

Finding the needed money may be the most difficult part of starting a business. The money required to start and operate a new business usually comes from a mixture of owner-supplied and borrowed funds.

CORPORATE SOCIAL RESPONSIBILITY



Global Social Responsibility

Many Europeans are concerned about their personal health and the health of their environment. In part, this concern is based on Europe's high population density. There are 3.6 times as many people per square mile in Europe as there are in the United States. Europe's high population density has led to concerns about waste disposal, air quality, and the availability of natural resources such as fresh water.

Some businesses based in the United States and doing business in Europe are working hard to address the concerns of European customers and governments, including that of the European Union. McDonald's wants to be seen as a socially responsible company and is developing policies and practices to address concerns about the nutritional value of their products and the impact of their operations on the environment.

Throughout Europe, McDonald's prints nutrition information directly on food containers and wrappers. This means consumers can see information about calories, fat, and sodium as they pluck fries out of the cardboard pouch.

McDonald's has launched an environmental initiative in southern England to convert used cooking oil into biodiesel. The fuel is used to power the company's delivery vehicles. This program removes cooking oil from the waste stream and reduces the consumption of gasoline.

Think Critically

1. What motivates U.S. companies to tailor their policies and practices to address the social concerns of global customers?
2. Research another company's efforts to be socially responsible and address social concerns around the world. Develop a short presentation about your findings.
3. Use the Internet to locate McDonald's Worldwide Corporate Responsibility Report. Write a summary of one of the programs mentioned in the report.

The source of owner-supplied money depends on the ownership structure. In a proprietorship, one person will supply the money. In most partnerships each partner will be expected to contribute. A corporation is owned and financed by the shareholders.

Borrowed funds are obtained through loans from banks and other financial institutions or through funding provided by other people, such as family and friends. Often companies that sell equipment, materials, or inventory to a business will offer credit if the business does not have financial problems. A new business owner should be careful about accepting credit. The owner must take

FYI

Bankers and other lenders use a written business plan to determine if the owner really understands the business and is committed to its success.

into account the cost of the credit and when payments are due.

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In addition to owner-supplied capital, what are several other sources of financing for a small business?

6-3

Assessment



Key Concepts

Determine the best answer.

1. Every business begins with a(n)
 - a. customer
 - b. profit
 - c. idea
 - d. invention
2. True or False. Most small business owners enjoy being part of a team.
3. True or False. A business plan does not have to be written because the business owner is well aware of the information in the plan.
4. Money needed for the important resources of a business (such as land, buildings, and equipment) that will last for many years is called
 - a. start-up financing
 - b. short-term financing
 - c. long-term financing
 - d. credit

Make Academic Connections

5. **Technology** Locate an outline for a business plan on the Internet. Compare the sections of the plan you found with those in Figure 6-4. Develop a final outline using both resources. Write a two sentence statement for each section of the outline describing why that section is important to a successful small business.
6. **Math** Gwen Osterhaus and Portia Juarez have formed a partnership to open a garden coffee cafe in Central Park. Gwen invests \$23,000 and Portia invests \$31,000. They get a micro loan from the Small Business Administration for \$18,500. They have \$9,000 of credit from the Bean Machine Company that sold them some of their equipment. Calculate the total amount of start-up financing available to the partnership. Make a pie chart that shows the percentage of total financing that is provided from each source. How much of the financing is owner supplied and how much is borrowed?

CHAPTER 6 Assessment

Xtra! Quiz Prep

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Business Notes

6-1 BECOMING AN ENTREPRENEUR

1. Successful entrepreneurs have a real desire to be their own boss. They use special skills and abilities to come up with innovative ideas and then develop a good initial plan for a business. Entrepreneurs come from all age categories, racial and ethnic groups, and both genders, as well as varied educational levels.
2. Entrepreneurship is a key part of the U.S. economy. Money needed to start a new business may come from the owner, family, friends, or venture capital. Other sources of financing are loans from banks and financial institutions and credit given by other businesses. Small businesses are responsible for nearly half of the U.S. gross domestic product each year and 55 percent of all innovative products and services developed.
3. Opportunities open to entrepreneurs include the creation of new or improved products and services, an improved design, more effective procedures, or greater attention to quality. Risks include lack of adequate capital, low sales, higher than expected expenses, competitive pressure, an owner unprepared to manage a growing business, and operations that require more time than the owner is willing to commit.

6-2 SMALL BUSINESS BASICS

4. In a small business, the owner is usually the manager, it operates in one or very few locations, it

typically serves a small market, and it is not dominant in its field of operation.

5. Small businesses play an important role in the economy. They often serve customers where the number of products and services needed is small or the requirements are too specialized for large businesses to be profitable.
6. The most common reasons for small business failure are not keeping adequate records, not having enough start-up money, lack of management experience, lack of experience with the type of business, not controlling operating expenses, poor location for the business, and failure to manage customer credit.

6-3 STARTING A SMALL BUSINESS

7. Factors that lead to a successful new business are an idea plus experience, the right time and place, a team approach, and preparation and research.
8. By developing a written business plan, the owner will think about important activities, the amount of time they will take, and their cost. The plan also serves as a guide to keep the business on track.
9. Obtaining adequate financing is an important step in starting and operating a new business. Three types of financing to be considered are start-up, short-term, and long-term financing. The money required to start and operate a new business usually comes from a mixture of owner-supplied and borrowed funds.

Communicate Business Concepts

1. What is a new product or service that could become the basis for a new business that fits your interests, hobbies, or special skills and abilities? What are some reasons you would be interested or not interested in becoming an entrepreneur?
2. Why do you believe that small businesses contribute more of the new jobs to the economy than large established businesses?
3. What are factors that you believe contributed to the success of the young entrepreneurs described in Lesson 6-1? Do you believe the idea for their product or service was more or less important than their personal characteristics?
4. How is the Internet changing the characteristics of small businesses? Do you believe the Internet can make small businesses more competitive with large businesses? Why?

5. Freddie is thinking about starting a small business and has come to you for advice. Using the reasons that most small businesses fail listed in Lesson 6-2, what would you tell Freddie that will help him increase his chances for being successful?
6. In most communities, there are several locations where retail businesses locate but soon fail. They are followed by other businesses that also fail. People say the pattern of failure is because of a poor location. Do you agree that the location is the most likely reason that the businesses fail? Why would a new business consider a location where a previous business has already failed?
7. Identify the three types of people you believe would be the most important to assist a new small business owner. Justify each of your choices.
8. If you were a banker reviewing a business plan to determine if you will provide financing, what information would be most important in determining if you would support the small business or not?
9. What are the advantages and disadvantages of hiring another experienced person to develop and write the business plan for the owner of a new business?

Develop Your Business Language

Match the terms listed with the definitions.

10. A government agency that helps small business owners develop business plans and obtain financing and other support for their companies.
11. Money provided by large investors to finance new products and new businesses that have a good chance to be very profitable.
12. The money needed to pay for the current operating activities of a business.
13. The amount of money needed to open the business.
14. An invention or creation that is brand new.
15. Someone who takes a risk in starting a business to earn a profit.
16. A written description of the business idea and how it will be carried out, including all major business activities.
17. Money needed for the important resources of a business (such as land, buildings, and equipment) that will last for many years.
18. An independent business with fewer than 500 employees.
19. A designed change that increases the usefulness of a product, service, or process.
20. The process of starting, organizing, managing, and assuming the responsibility for a business.

KEY TERMS

- a. business plan
- b. entrepreneur
- c. entrepreneurship
- d. improvement
- e. innovation
- f. long-term financing
- g. short-term financing
- h. small business
- i. Small Business Administration (SBA)
- j. start-up financing
- k. venture capital

Make Academic Connections

21. **TECHNOLOGY** Use the Internet to identify the number of small business owners by race or by age. Then enter the information in a spreadsheet program and calculate the percentage of all small business owners represented by each race or age classification. Then use the graphing function to create a chart or graph illustrating the results.
22. **COMMUNICATION** Many small business owners obtain some of their start-up financing from family members and friends. Assume you are starting a small Internet business that will develop and maintain low-cost web sites for local organizations, clubs, and nonprofit groups. You have \$2,500 of your own money to invest and need to raise an additional \$5,000. Develop a letter or one-page brochure that you can use to interest family and friends in investing \$500 or more in your new business. Make sure it is persuasive and tells them what benefits they will receive from their investment.
23. **PERSONAL DEVELOPMENT** The characteristics common to most entrepreneurs are listed in Figure 6-1. Create a table with three columns. In the first column, list each of the characteristics. In the middle column, describe things you have done (hobbies, work, projects, activities) that provide evidence of each characteristic. In the final column, list additional things you can do in the next five years to further develop the characteristic.
24. **GOVERNMENT** The federal government and most state governments provide many resources as well as financial support for small businesses. Use the Internet to locate two agencies of the federal government that provide services developed specifically for small businesses. Then search the web site for your state's government and locate one state agency that provides small business services. Prepare a three-paragraph report on each of the agencies you identified in which you describe the agency, the services provided, and how a new business can qualify for the services.
25. **ECONOMICS** The U.S. Census Bureau maintains information on the number of businesses and amount of business activity in every county of each state. Use the Internet to visit the U.S. Census Bureau web site (www.census.gov). Use the search engine on their web site to locate "County Business Patterns." View the county data by clicking on the hypertext table link. When you have accessed that web page, enter the name of your state and then the county in which you live. Find data on the number of businesses with one to four employees in your county. List the total number of businesses of that size, the five industries with the most businesses employing fewer than five employees, and the total number of establishments in each of those industries.

Linking School and Community

Survey at least 10 people in your community about their experiences as consumers with small businesses and large businesses. Ask them to describe the reasons they prefer to buy from small businesses and

the reasons they prefer to buy from large businesses. Then ask them to describe the disadvantages of each. Summarize the results of your discussions in a chart or short written report.

Web Workout

The Internet is the ultimate niche small business platform. The Internet can bring together sellers and individual buyers at a very low cost. Many small businesses, including home-based businesses, use portals such as Amazon.com and eBay to sell their products. This way, the small business owner does not need to set up their own web site or e-commerce system.

Think Critically

1. Use the Internet to find a niche seller (a product with a very narrow appeal). Determine if the seller uses a sales portal (like Amazon.com or eBay) or if they have their own web site.
2. Identify a niche product that you would like to sell. Develop a short business plan to determine if it would be better to sell through a sales portal or by developing your own web site.

Decision-Making Strategies

David Obolski completed a community college program in Small Business Management. He now wanted to own his own floral business. He had worked for Flower-a-Bunda during high school and college. In addition, he was able to save almost \$20,000 toward starting his own business. However, he knew that he would need more than \$20,000 to buy a florist shop. He would need almost double that amount to qualify for the necessary loans to start up the business. David studied three ways he might start his business.

- a. He could find a partner to provide the additional cash.
- b. He could work for the owner of Flower-a-Bunda until she retired in seven years and

buy the business with his accumulated savings.

- c. He could purchase a franchise for an investment of \$20,000. However, David would have to pay a franchise fee of 6 percent of total sales each year to the franchisor.
26. What are the advantages and disadvantages of each route to small business ownership for David?
27. If you were David, which choice would you make? Why?

American Enterprise Project

The United States takes great pride in the American enterprise system, which encourages individuals to take the risk of starting a business.

Consumers play an important role in the American enterprise system. Their demand for goods and services influences which businesses will be successful. Business success depends upon paying attention to consumer demand.

Your team of three individuals has been challenged to design a presentation that teaches elementary students about the American enterprise system. Your presentation should teach students about supply and demand and the American dream of owning a business. The presentation should include active participation of the elementary students.

You will create a business report with substantiated statements in a clear and concise format. Creativity through design and use of meaningful graphics is encouraged. The report should be a clear presentation about the American enterprise system and your strategy for teaching elementary students key concepts. The report should include the following parts: Purpose of project, Research into school and/or community needs, Description of project, Uniqueness of project, and Evaluation and results. The format of your report will be evaluated for clear and concise presentation with logical arrangements of information; creativity in presentation; and correct grammar, punctuation, spelling, and acceptable business style.

PERFORMANCE INDICATORS EVALUATED

- Understand the major concepts about the American enterprise system.
- Present an effective lesson to elementary students.
- Highlight measurable results from the American Enterprise Project.
- Reach goals for the American Enterprise Project.

For more detailed information about performance indicators, go to the FBLA web site.

Think Critically

1. Why is it important for young Americans to understand the American enterprise system?
2. List two strategies to use during the presentation that will hold the attention of elementary students.
3. List five major concepts that elementary students must understand about the American enterprise system.
4. What would be a good joint project between FBLA/BPA members and elementary students to strengthen understanding about the American Enterprise System?

<http://www.fbla-pbl.org/>



Portfolio Activity

school.cengage.com/business/introtobiz

Access the web site shown here to find portfolio activities for this chapter. Use the activities to provide tangible evidence of your learning.